(20)

FILED
OCT 9 1945
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

October Term, 1945.

No. 388.

THE UNITED STATES, *Petitioner,*

v.

HORACE HAVEMEYER.

On Petition For a Writ of Certiorari to the Court of Claims.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

PRESTON B. KAVANAGH,
Munsey Building,
Washington 4, D. C.

WILLIAM M. SPERRY, 2nd,
52 William Street,
New York, 5, N. Y.,
Counsel for Respondent.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

INDEX.

	Page
Opinion below	1
Jurisdiction	1
Statutes involved	2
Question presented	2
Statement	2
Argument	6
1. Fair Market value is a question of fact	7
2. The Treasury Regulations support the decision of the Court of Claims	10
Conclusion	12
Appendix	13

CITATIONS.

CASES:

Allen v. Commissioner, 3 T. C. 1224	9
Avery v. Commissioner, 3 T. C. 963	9
Bull v. Smith, 119 F. 2d 490	9
Commissioner v. Shattuck, 97 F. 2d 790	8, 9
DuPont v. Commissioner, 2 T. C. 246	9
DuPont v. Deputy, 26 F. Supp. 773	9, 11, 12
Estate of Frederick Bodell, 47 B. T. A. 62	9
Gamble v. Commissioner, 101 F. 2d 565, certiorari denied, 306 U. S. 664	9
Groff v. Munford, decided July 19, 1945	9
Groff v. Smith, 34 F. Supp. 319	9
Helvering v. Kimberly, 97 F. 2d 433	9
Helvering v. Maytag, 125 F. 2d 55, certiorari denied 316 U. S. 689	9, 11
Helvering v. Safe Deposit & Trust Co., 95 F. 2d 806	9
Jenkins v. Smith, 21 F. Supp. 251	9
Mott v. Commissioner, 139 F. 2d 317	9
Page v. Howell, 116 F. 2d 158	9

Page

Phipps v. Commissioner, 127 F. 2d 214, certiorari denied, 317 U. S. 645 9
Richardson v. Commissioner, decided August 17, 1945 9
Safe Deposit & Trust Co. of Baltimore, 35 B. T. A. 259 8
Standard Oil Co. v. Southern Pacific Co., 268 U. S. 146 7

STATUTES:

Internal Revenue Code:
Sec. 1000 (26 U. S. C. Sec. 1000) 13
Revenue Act of 1932, (c. 209, 47 Stat. 169):
Sec. 501 13
Sec. 502 13
Sec. 504 ..... 13, 14
Sec. 505 14
Sec. 506 ..... 7, 14
Sec. 530 14
Act of February 13, 1925:
Sec. 3(b), (c. 229, 43 Stat. 939) 1, 2

MISCELLANEOUS:

T. D. 4901, 1939—1 C. B. (Part 1) 341 ..... 10, 11, 16, 17, 18, 19
Treasury Regulations 79 (1933 Ed.) Art. 19 .. 10, 11, 14, 15
Treasury Regulations 79 (1936 Ed.) Art. 19 .. 10, 11, 15, 16
Treasury Regulations 108 (1943 Ed.) Sec. 86.19 19

IN THE

Supreme Court of the United States

October Term, 1945.

No. 388.

THE UNITED STATES, *Petitioner,*

v.

HORACE HAVEMEYER.

On Petition For a Writ of Certiorari to the Court of Claims.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

OPINION BELOW.

The opinion of the Court of Claims is reported in 59 F. Supp. 537. It appears in the Record at pages 17-28. The special findings of the Court of Claims are at pages 5-17 of the Record and the dissenting opinion of Judge Madden is at pages 28-30.

JURISDICTION.

The Judgment of the Court of Claims was entered on April 2, 1945. (R. 30). Time for filing petition for a writ of certiorari was extended to August 31, 1945, by order of this Court dated June 16, 1945. (R. 31). The jurisdiction of this Court is invoked under Section 3(b)

of the Act of February 13, 1925, as amended by the Act of May 22, 1939.

STATUTES INVOLVED.

The pertinent provisions of the Revenue Act of 1932 and of the Regulations of the Treasury Department relating to gift taxes are printed in the Appendix, pages 13-19, *infra*.

QUESTION PRESENTED.

The Court of Claims was required to find the fair market value for gift tax purposes of 160,000 shares of one corporate stock and 20,000 shares of another. In determining fair market value that court considered, as one factor among many, the effect upon fair market value of the size of the blocks of stock to be valued. In so doing, the court refused to be bound by the quoted prices at which very much smaller numbers of shares of these stocks were selling on the New York Stock Exchange at or about the date of the gifts. Petitioner does not challenge the correctness of the court's determination of value, upon all the facts, but insists that the court was bound to adhere to quoted stock market prices and was not at liberty to consider other evidence of actual value.

The question presented is whether the Court of Claims erred by finding actual fair market values instead of adopting petitioner's restrictive formula.

STATEMENT.

The Special Findings of the Court of Claims (R. 5-17) may be summarized as follows:

On November 19, 1934, respondent, a citizen and resident of New York State, donated 160,000 shares of the common stock of Great Western Sugar Company and

20,000 shares of the common stock of South Porto Rico Sugar Company to four trusts. Each trust received 40,000 shares of Great Western stock and 5,000 shares of South Porto Rico stock. (R. 5, 6).

Respondent filed a federal gift tax return and reported these gifts for taxation (R. 5). They were valued on the return at $28.125 per share for the Great Western stock and $24.50 per share for the South Porto Rico stock. These two stocks were listed on the New York Stock Exchange and the returned values represented the mean between the highest and lowest quoted selling prices on the date of the gift. (R. 6). By claim for refund (R. 6) and suit in the Court of Claims (R. 1), respondent maintained that he had overvalued the Great Western and South Porto Rico stocks on the return.

Great Western Sugar Company is a domestic beet sugar producer (R. 9). South Porto Rico Sugar Company is an off shore producer of cane sugar in Puerto Rico and Santo Domingo (R. 12). In November 1934 and for some time prior thereto sugar producers suffered from an oversupply of sugar in the world markets and a resulting steady decline in sugar prices (R. 14, 15). By reason of this fact, as well as the tariff situation and uncertainty regarding sugar quotas which materially reduced the salable sugar, informed opinion in financial circles at that time considered the outlook for future earnings of these corporations to be unfavorable (R. 15).

Both Great Western and South Porto Rico common stocks were traded in on the New York Stock Exchange (R. 6, 10, 11, 12, 13, 14). At November 1934 both the prices at which these stocks sold and the volume in which they were traded had been declining steadily for

a year (R. 15). They were moving down against a rising market in which the better grade industrials more than held their own during the same period. (R. 15).

On November 19, 1934, 2,500 shares of Great Western were sold on the Exchange (R. 10). During the week ended November 24, 1934, 7,100 shares were sold and, for the whole month, 26,900 shares (R. 11). For the same period the daily, weekly and monthly sales of South Porto Rico were 900, 4,300 and 19,600 shares respectively. (R. 13, 14).

The markets for Great Western and South Porto Rico stocks on or about November 19, 1934, were reasonably good from the standpoint of volume of trading, free from misrepresentation or manipulation, and were free, open markets where prices were determined by supply and demand. The prevailing prices of these stocks on the New York Exchange on November 19, 1934, were fair prices for the volume of stock being traded on the market at that time. (R. 15).

On November 19, 1934, an additional 160,000 shares of Great Western common stock or 20,000 shares of South Porto Rico common stock could not have been sold on the New York Stock Exchange without depressing the price.* The size of a block of corporate shares

*The Court of Claims stated in its opinion (R. 23)—"Any attempt to dispose of these blocks of Great Western and South Porto Rico would have depressed the market over the long term necessary to sell the shares. There was no particular demand for either of these stocks in excess of the amount being currently traded in. The 160,000 shares of Great Western represent 6,400% of the 2,500 shares actually traded on November 19, 1934, 3,700% of the 7,100 shares sold during that week, and 816% of the 26,900 shares sold during November 1934. The 20,000 shares of South Porto Rico were 2,222% of the 900 shares actually sold on November 19, 1934, 465% of the sales of 4,300 shares for the week, and 102% of the sales of 19,600 shares for the month of November."

becomes an important element in determining the amount that can be realized from the sale of those shares on a given date when the block is larger than the current market can absorb without price dislocation. On occasion the amount which can be realized from the individual shares making up the block may be enhanced if the block carries with it control of the corporation and a purchaser anxious to secure that control can be found. The element of control stock did not prevail with respect to the stock involved in this case since 160,000 shares of Great Western was equal to only 8.89 percent of a total of 1,800,000 shares outstanding, and the 20,000 shares of South Porto Rico was equal to only 2.68 percent of a total of 745,735 shares outstanding. (R. 16).

The method of marketing these blocks of Great Western and South Porto Rico stocks which would have yielded the greatest return to a seller on November 19, 1934, would have been a sale to a group of investment bankers forming an underwriting syndicate for the purchase of the shares with the intention of reselling them to the public. In the case of the Great Western stock two or three bankers would probably have constituted the original purchasing group who would have associated with them a secondary group of ten or twelve to spread the risk. A third or selling group of several times that number would have been assembled. The syndicate would plan to offer the stock to the public through the facilities of its selling group at a price fractionally under the market in order to stimulate sales. For the Great Western stock on November 19, 1934, the offering price to the public would have been in the neighborhood of 27½ as against a low for the day on the Exchange of 27⅞. For their services and expenses the underwriters and their associates would require a spread or compensation of about 2½ to 3 points

a share which would be deducted from the public offering price in figuring the amount which the underwriters would pay for the stock. Under a sale in that manner, a seller of 160,000 shares of Great Western Stock on November 19, 1934, could reasonably have expected to have received approximately $25 a share. A similar method of marketing the South Porto Rico stock would have been followed except that the smaller money risk involved would have permitted the elimination of the secondary group of underwriters and would thus have eliminated a portion of the underwriting spread. That transaction could have been handled on a 2 point spread with the public offering of the shares at 24 (against a market low for the day of 24¼) and the consequent payment to the seller by the underwriters of $22 a share. (R. 16, 17).

The actual fair market value on November 19, 1934, of the 160,000 shares of stock of Great Western was $25 a share, or $4,000,000; and the actual fair market value of the 20,000 shares of stock of South Porto Rico on November 19, 1934, was $22 a share, or $490,000. (R. 17).

ARGUMENT.

The Court of Claims decided this case on two grounds. The court held, and petitioner does not question, that respondent proved that the actual fair market value of Great Western stock was $25.00 per share and that the actual fair market value of South Porto Rico stock was $22.00 per share, both on the date of gift, November 19, 1934. The court likewise held that the admission of respondent's evidence on value was fully sanctioned by the Regulations issued by the Treasury.

1. Fair market value is a question of fact.

Value is an ultimate fact to be established. There is no general rule of thumb or formula which must be followed in every case to the exclusion of all other factors. As this Court says in *Standard Oil Co.* v. *Southern Pacific Co.*, 268 U. S. 146, 156:

> "The ascertainment of value is not controlled by artificial rules. It is not a matter of formulas, but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts."

Sec. 506 of the Revenue Act of 1932 provides that—

> "If the gift is made in property, the value thereof at the date of gift shall be considered the amount of the gift."

Both petitioner and respondent agree that the unadorned word "value" in the statute means *fair market value*. The Treasury Regulations, quoted in the Appendix, pages 14-19, *infra*, provide that "the value of property is the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell." In other words, it is a price negotiated at arms length, which, where no sale actually takes place, must be established by competent and convincing evidence, as was done in this case.

The Court of Claims found as a fact that a possible purchaser or purchasers of Great Western or South Porto Rico stock on the date of the gift would take into consideration the number of shares here involved; and that a seller of that number of shares would be compelled to negotiate with an underwriting syndicate in order to secure the highest return. In the face of such a finding it is idle to urge, as petitioner does, that a

rigid standard of stock market prices should be substituted, after respondent has proved and the court below has found that there was no willing buyer for these shares at stock market prices.

The effect of size or number of units on market price is well known. It is a fact to be reckoned with. Petitioner's position ignores the well known fact that quantity purchases in our economy are ordinarily made at a discount. Every well informed buyer would expect to pay less for fifty bales of hay than for one bale if the supply exceeds the demand. This is true of wheat, hogs and corporate stocks. *Commissioner* v. *Shattuck,* (C. C. A. 7), 97 F. 2d, 790, 792.

Respondent has never claimed that size alone creates a legal presumption but only that it is a factor to be considered, insofar as it has a demonstrable effect on fair market value. The Board of Tax Appeals (now the Tax Court) stated the matter very well in *Safe Deposit & Trust Co. of Baltimore,* 35 B. T. A. 259, 263-264:

> "'Blockage' is not a law of economics, a principle of law, or a rule of evidence. If the value of a given number of shares is influenced by the size of the block, this is a matter of evidence and not of doctrinaire assumption. See *James Couzens,* 11 B. T. A. 1040, 1161; *T. B. Hoffer,* 24 B. T. A. 22; *Laird* v. *Commissioner,* 85 F. 2d 598; *Rogers* v. *Strong,* 72 F. 2d 455; *William S. Gordon, Trustee,* 33 B. T. A. 460; *St. Louis Union Trust Co. et al., Trustees,* 30 B. T. A. 370, 381; *Frank J. Kier et al., Executors,* 28 B. T. A. 633."

No doubt petitioner is correct (Petition, page 10) in saying that many estate and gift tax cases are pending before the Bureau of Internal Revenue in which this question is involved as an element in valuation.

We venture to assert, however, that a far greater number of cases are before the Bureau for decision on other fact questions, such as the time for deducting bad debts or what constitutes reasonable compensation. Taxpayers and the Bureau frequently disagree about the facts of a case but that has never been regarded as a ground for the exercise of the discretionary jurisdiction of this Court. Actually, this Court has three times refused review in the very type of case which petitioner here presents. *Helvering* v. *Maytag*, 316 U. S. 689 (125 F. 2d 55); *Phipps* v. *Commissioner*, 317 U. S. 645 (127 F. 2d 214); *Gamble* v. *Commissioner*, 306 U. S. 664 (101 F. 2d 565).

The state of the law is not in confusion on this point. The courts have uniformly treated the effect on value of the size of a block of securities as a question of fact to be proved. Where, as here, the proof is to the satisfaction of the court, the taxpayer wins.* If he fails to sustain the burden of proof, he loses.**

The majority of cases arise in the Tax Court, which, with its predecessor the Board of Tax Appeals, has proved itself fully able to deal with them. The burden on any trial court in this type of case is no greater than

---

* *Groff* v. *Munford* (C.C.A. 2) decided July 19, 1945 (1945 Prentice-Hall, par. 72631); *Helvering* v. *Maytag*, *supra*; *Helvering* v. *Safe Deposit & Trust Co. of Baltimore* (C.C.A. 4), 95 F. 2d 806; *Commissioner* v. *Shattuck*, *supra*; *Page* v. *Howell* (C.C.A. 5), 116 F. 2d 158; *Helvering* v. *Kimberly* (C.C.A. 4), 97 F. 2d 433; *DuPont* v. *Deputy* (Dist. Ct. Del.), 26 F. Supp. 773; *Jenkins* v. *Smith* (Dist. Ct. Conn.), 21 F. Supp. 251; *Avery* v. *Commissioner*, 3 T. C. 963; *DuPont* v. *Commissioner*, 2 T. C. 246; *Estate of Frederick Bodell*, 47 B.T.A. 62.

** *Richardson* v. *Commissioner* (C.C.A. 2), decided August 17, 1945 (1945 Prentice-Hall, par. 72649); *Mott* v. *Commissioner* (C. C. A. 6), 139 F. 2d 317; *Phipps* v. *Commissioner*, *supra*; *Gamble* v. *Commissioner*, *supra*; *Bull* v. *Smith* (C.C.A. 2), 119 F. 2d 490; *Groff* v. *Smith* (Dist. Ct. Conn.), 34 F. Supp. 319; *Allen* v. *Commissioner*, 3 T. C. 1224.

the ordinary burden of weighing the evidence and finding the facts. The petitioner had its day in the Court of Claims and has not shown convincing grounds for a review of the decision of that court.

2. The Treasury Regulations support the decision of the Court of Claims.

The Gift Tax Regulations applicable to the valuation of shares of stock are quoted in the Appendix, pages 14-19. The original Regulations 79 (1933 Edition) have been twice amended, once in 1936 and again in 1939.

In their original and amended form, the Regulations provided substantially as follows with respect to valuation:

1. (1933-1936). Listed stocks shall be valued at the mean between high and low selling prices on the stock exchange, *except where such selling prices do not reflect the fair market value of the gift.* (Regulations 79, 1933 Edition, Appendix, page 14, 15).

2. (1936-1939).. Listed stocks shall be valued at the mean between high and low selling prices on the stock exchange. *Each share of stock is to be valued separately and the size of the gift of any security is not a relevant factor and will not be considered in such determination of value.* (Regulations 79, 1936 Edition, Appendix, page 15, 16).

3. (1939-1945).. Listed stocks shall be valued at the mean between high and low selling prices on the stock exchange. *Where such method does not reflect the fair market value of the gift, then some reasonable modification or other relevant facts and elements of value shall be considered in determining fair market value.* (Treasury Decision 4901, approved May 18, 1939, Appendix, page 17, 19).

It is at once apparent that No. 1 and No. 3, above, set forth substantially the same standard. No. 1 was in force when the gifts in this case were made. No. 3 is now in force and has been since 1939. They provide a general rule of valuation—the mean between high and low prices on the exchange—but require the use of that rule only so long as it reflects fair market value of the actual gift. If it does not, the way is open to prove what is fair market value under the particular circumstances. Plaintiff in this case has proved, *first*, that the exchange prices did not constitute fair market values here and, *second*, what the fair market values actually were. This proof is in strict accordance with the Regulations in force from 1933 to 1936 and from 1939 to the present day. The Court of Claims so holds in its opinion. (R. 20).

The Regulations paraphrased in No. 2, above, while they were in force, undoubtedly were intended to support just such an argument as petitioner makes in this case. They introduced and kept in force, from 1936 to 1939, a rigid rule which ignored realities. This rule was rejected by the courts and finally withdrawn by the Department. See Opinion, (R. 20); *Helvering* v. *Maytag, supra,* at pages 62-63; *DuPont* v. *Deputy, supra,* at page 783. In the last named case the court said:

> "The defendant relies upon an amendment to the gift tax regulations in 1936 which provides: 'The size of the gift of any security is not a relevant factor and will not be considered in such determination.'
>
> "By this regulation the Commissioner substituted an arbitrary rule for the statutory provision that the value of the property should govern. Litigation resulted. The courts have been unanimous in declaring that the determining of value is

not to be restricted by such arbitrary rule and that all relevant factors must be considered. The size of the block of securities is a relevant factor."

CONCLUSION.

For the foregoing reasons it is respectfully submitted that the petition for a writ of certiorari should be denied.

PRESTON B. KAVANAGH,
Munsey Building,
Washington 4, D. C.

WILLIAM M. SPERRY, 2nd,
52 William Street,
New York, 5, N. Y.,
Counsel for Respondent.